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RR RUEHLH RUEHPW
DE RUEHIL #0315/01 0440812
ZNR UUUUU ZZH
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FM AMEMBASSY ISLAMABAD
TO RUEHC/SECSTATE WASHDC 1447
INFO RUEHLH/AMCONSUL LAHORE 6745
RUEHPW/AMCONSUL PESHAWAR 5668
RUEHKP/AMCONSUL KARACHI 1047
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RUEHFR/AMEMBASSY PARIS 6978
RHEHNSC/NSC WASHINGTON DC
RUEAIIA/CIA WASHDC
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RUEKJCS/JOINT STAFF WASHINGTON DC
RUEKJCS/SECDEF WASHINGTON DC
RUMICEA/USCENTCOM INTEL CEN MACDILL AFB FL

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SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: [ENRG](#) [ECON](#) [EFIN](#) [PK](#)
SUBJECT: PAKISTAN'S ENERGY CRISIS - IMPROVING, BUT CHALLENGES
REMAIN

REFS:
(A) 08 Karachi 0600
(B) 08 Karachi 0587
(C) 08 Islamabad 3647

¶1. (SBU) Summary: The GOP is making some headway fulfilling President Zardari's January directive to clear up the "circular" debt situation that is wreaking havoc among power producers, but confidence varies that it will be paid off in its entirety any time soon. Blackouts have been reduced from over eight hours per day to an average of four to six hours per day in Islamabad and to as little as two hours per day in Karachi, due primarily to lower winter demand and additional hydel generation. But the GOP goal of eliminating blackouts altogether by year's end seems unlikely, in light of ongoing financial pressures, rising demand, and the complex system of subsidies and controls that creates bottlenecks in crucial fuel supplies. The GOP says its plan to remove electricity subsidies by June 30 is in place, but another spike in world oil prices could easily derail it. End Summary.

GOP Coming to Grips With "Circular" Debt?

¶2. (SBU) The GOP appears to be making honest efforts to get a handle on the perennial "circular debt" issue that has flared up in the wake of spiking oil prices. Estimates vary widely, but the GOP's debt to Independent Power Producers (IPPs) is quoted as being well over \$2 billion. The IPPs, in turn, owe money to Pakistan State Oil Corporation (PSO) and others to pay for fuel. This debt accumulated as a result of high oil prices, the GOP's unwillingness to do away with a network of unwieldy price controls and supports, and increasingly unaffordable subsidies in the run-up to national elections in February 2008. Businesses and citizens alike protested Pakistan's increasingly unreliable electricity grid, and reacted strongly when the GOP raised electricity tariffs in September, a move which they then partially rescinded (refs B and C). The situation finally reached crisis proportions in December 2008. Street protests and business shutdowns (Ref A) led President Zardari to convoke his economic team in January 2009, demanding they resolve the payment problems and come up with a plan for dealing with the nation's energy crisis. Zardari instructed his team to resolve the GOP debt by June 2009 and end loadshedding altogether by the end of the calendar year.

13. (SBU) Pervais Khan, Chief Executive Officer of Uch Power, confirmed to the Ambassador February 6 that Uch had been paid its regular monthly fees in December and January, and that he believed these timely payments would continue. Khan said he was confident the GOP would have paid Uch as much as half of the GOP's outstanding debt by the end of February, and that the balance would be paid in installments through July. Chevron General Manager Irfan Qureshi confirmed February 10 that his oil marketing company had received all the money owed them (\$25 million), but only after Embassy intervention. Even American-owned AES, to whom the GOP owes some \$227 million (of which \$108 million is technically in default), acknowledged that the GOP had made current payments for the last two months. AES, however, did not share Khan's confidence that past due amounts would be paid.

Better News on Blackouts

14. (U) Blackouts persist around the country, including in Karachi (Ref A) but their duration and frequency have been reduced, due in large part to the release of some 25 million cubic meters of water to power Pakistan's hydro-electric generators and lower winter demand. Ministry of Water and Power (MWP) Joint Secretary for Power Arshad Mehmood told Econoff February 11 Pakistan was generating 11,200 MW against demand of 11,582 MW. The 382 MW gap is a fraction of the 4,500 MW generating shortfall less than two months ago. Blackouts in Karachi now range from two to eight hours per day, down from four to more than 12 hours a day during the peak summer season.

KESC General Manager Naveed Ismail told Karachi CG January 27 that many of Karachi's longer blackouts can currently be attributed to

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its decrepit transmission systems. In Islamabad, rolling blackouts in February are averaging from four to six hours per day, down from over eight hours in November/December. Mehmood expressed frustration with a rotating maintenance schedule that continued to take power offline in Islamabad in February, despite MWP success in reducing loadshedding in the capital.

15. (SBU) Mehmood admitted however, that increased summer demand would again put the GOP behind the curve in providing power. He predicted that the summer 2009 generating shortfall could climb as high as 5,000 MW, despite GOP plans to add additional power to the grid and make substantial investments in Karachi's decrepit transmission and distribution infrastructure.

On Track for the SBA?

16. (SBU) MWP Additional Secretary Zarar Aslam expressed confidence that Pakistan was on track to meet the IMF's requirement to remove electricity subsidies by June 30, 2009. According to Aslam, the GOP intends to raise tariffs by one percent each month from March through June. By June, this four percent increase, along with lower oil prices and previous tariff increases in 2008 that Aslam claimed totaled 18 percent, will eliminate the GOP electricity subsidy and meet the IMF benchmark. When asked what would happen to this hopeful scenario should oil prices again rise precipitously, MWP Joint Secretary Mehmood said that a new system of biweekly (vice monthly) adjustments to the price for oil products, biweekly payments to power companies, and monthly adjustments to the electricity tariff rate meant that the GOP would no longer fall victim of a pricing system that could not keep pace with market developments and left the GOP paying the bill.

Finance Still a Challenge

17. (U) In line with Pakistan's commitments to the International Monetary Fund (IMF), the State Bank of Pakistan announced February 6 that it would phase out the use of Pakistan's precious foreign exchange reserves to pay for oil and fuel imports. Kalim Siddiqui, Managing Director of the Pakistan State Oil Company (PSO) was quoted in the press February 10 as confidently predicting PSO's ability to finance its imports commercially, following reports that PSO was suspending a tender for gasoline because the Ministry of Finance was

refusing to release the necessary funds.

¶8. (SBU) PSO's bravado aside, the reality is that Pakistan's low credit rating means that suppliers remain reluctant to grant the GOP any terms but cash to pay for oil imports. However, Kuwait February 5 agreed to provide 60-day deferred financing to Pakistan for a second year. Iran had already entered into a 90-day extended payment arrangement in January. Pakistan's inability to finance its crude oil purchases reliably has caused ripple effects throughout the oil products sector, as domestic production of liquefied petroleum gas (LPG), heavy fuel or "furnace" oil, and other refined products drops in tandem with crude imports, and the GOP faces the same difficulty financing imports to replace them.

¶9. (SBU) Comment: Our contacts at MWP claim that both the IMF and the World Bank are on board with their plan to eliminate electricity subsidies. While the gradual approach seems sound (especially in light of negative public reaction to the GOP effort to impose an "all at once" 31 percent price increase in the fall), it hinges for the most part on continued lower oil prices. The structural adjustments to the cumbersome GOP pricing system may help the GOP more readily pass on higher fuel and generating costs to the consumer, but a significant loophole remains. The National Electric Power Regulating Authority (NEPRA) sets the price paid to electricity producers, but the GOP retains authority to set a lower price for consumers - leaving the door open for subsidies to reappear in future.

¶10. (SBU) Comment continued: Aslam and Mehmood were proud that the payments are now current to Pakistan's power producers and our

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conversations with several IPPs seem to bear out this assertion. The GOP plan to address the outstanding debts is still being developed, but the GOP seems determined and has tasked the Ministry of Finance to tackle the debt problem "as a priority." Mehmood said the GOP is considering the sale of some (unspecified) WAPDA property or possibly issuing bonds ("term finance certificates") to raise funds to cover the debt. Should these efforts not bear results, and with borrowing from the State Bank of Pakistan strictly limited under the IMF agreement, it is unclear where the needed funds will come from.